



Risk Management: Information Technology

Rural Lending in Sierra Norte-Ecuador

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This case study was made possible by support provided in part by the US Agency for International Development (USAID) Agreement No. LAG-A-00-96-90016-00 through Broadening Access and Strengthening Input Market Systems Collaborative Research Support Program (BASIS-CRSP) and the World Council of Credit Unions, Inc. (WOCCU).

All views, interpretations, recommendations, and conclusions expressed in this paper are those of the author (s) and not necessarily those of the supporting or collaborating institutions.

✓The organization

Banco Solidario S.A.. was founded in 1995 in Quito, Ecuador. Originally, it was sponsored by local private capital, however at present it shares foreign capital linked to the microfinance industry.

Banco Solidario's organizational mission balances financial and social profitability by facilitating access to financial services to segments of the population that face obstacles in the traditional financial system. (See Annex A: Banco Solidario's Mission)

To date, Banco Solidario has a portfolio made up of 11 products and/or services. It has 23 agencies and 553 officials.

At year-end 2002, the bank's total portfolio was US\$43,162,000 with a 5.20% delinquency of over 30 days.

Since 1998, the bank began using, as an experiment, several rural methodologies available in the market. However, it was not until the beginning of 2001 that the bank decided to design and develop a rural loan portfolio of its own. To date, the bank has completed individual lending massification and is running the pilot test in the group lending products.

Rural portfolio to Dec 2002 reaches US **\$5,269,527.00** , with a total of 5,007 clients. See Annex B: Portfolio Report

✓The project

In November 2000, Banco Solidario and Fundación Alternativa (a non-profit organization connected to the bank through the Grupo Enlace) began a rural lending project sponsored by the Belgian Technical Cooperation and with ACCION International's technical support. The purpose of the project was to design, develop and implement a rural lending portfolio that allowed the bank to increase the scope, depth and coverage of its loan portfolio for the microenterprise sector.

In addition, in August, 2001, Fundación Alternativa, began an additional project – with PL 480 support – to work with a subsistence profile segment of the market.

These two projects, executed in parallel, allowed on one hand, adding a product to the portfolio (to serve a lower income segment of the population) and on the other, to comparatively analyze the portfolio behavior – regarding both cost and loan management aspects – in a regulated organization vs. a non-regulated one. Contributing, therefore, to the generation of the examination, at an operational detailed level, of the impact of regulations on loan viability in the rural area.

In addition, at the same time as the rural portfolio was being developed, the project helped to install capacity in the bank in the structuring and automation of a product development process.

✓*Product development process*

The first activity in the project was the introduction – by ACCION – of a product development methodology that would guide the development of the activities and tasks executed via a multidisciplinary team, thus generating the synergy and the commitment necessary in such an effort. It also generated the capacity of the bank to respond in a rational and orderly manner to market demand when designing and/or redesigning products.

In the *first phase* (analysis and internal preparation) the strategic decision of expanding to rural areas was explored. At the same time, the operational implications of this expansion were identified, assessing the internal and external environments under which the project would be developed. The Banco Solidario–Fundación Alternativa alliance made possible a strategy that could serve several market niches in one area (see Annex C: Products and Niches of Target Market), determining the development of a range of products (five in total of which four have been developed and implemented).

A strategic decision assumed from the beginning was that the rural portfolio would not only concentrate on agricultural activities, but would also include trade and service sectors of the area. At first, placement was divided among these three activities–taking into account the natural distribution of these activities in the area–in such a way as to preliminarily observe the portfolio’s behavior, while managing risk in a less concentrated way. It was also determined that the clients should have at least two sources of income in their economic unit.

During the second phase (prototype design and development) the activities were designed based upon qualitative research studies, through focal groups and quantitative studies, through the implementation of a survey. This allowed the bank to identify the profile of the target segments, as well as clients' needs and expectations. Additional data was collected on financial services offered in the area, as well as on the clients’ level of satisfaction with the service. Based on the results of these studies, basic attributes were determined and product modalities were defined. The team designed the operational flows and documented the procedures in manuals and guidelines that were good for both the definition of a management module and portfolio management parameters as well as training material for the staff – field and office – in charge of marketing the portfolio.

Both individual and group products have been designed using a common matrix that allows the use of the same process and the same instruments, setting parameters regarding the depth and scope of economic assessment that especially depend on the product. This allows, for example, entering a client through one product, collecting basic information, and then as the client shows progress in his business, in addition to his behavior as a borrower, the client may access other products, gradually incorporating more information, until arriving at individual lending.

The *third phase* (pilot) allowed marketing, in a controlled market, of the different product modalities, and collecting clients’ satisfaction. It also analyzes operational challenges of integrating market products and segments into the organization. The first pilot product –

August 2001 – was individual rural lending at Ibarra's Regional office, the agency of Cayambe (in the province of Imbabura).

Cayambe is a city of around 50,000 inhabitants whose main economic activities are flower cultivation, dairy products and small-scaled farming for local consumption. This pilot, implemented in an open mode where adjustments can be systematically made to a product prototype, lasted approximately 6 months. After that, final adjustments were made to the prototype and to the operational support mechanisms (particularly those related to the system).

The second pilot started in October 2002 – currently under execution – it is piloting group lending modalities (Multipliers, Solidarity Nuclei, Solidarity Groups). This pilot is being implemented in the province of Imbabura (cities of Cotacachi, Pimampiro, Atuntaqui)

The *fourth phase* (massification) was focused on training and operational set-up of support tools for the integration of an individual rural lending product into the portfolio of the distribution points nationwide. In August 2002, the bank decided to integrate individual loans to its portfolio nationwide. This process has required not only the promotion and selling of this new product, but also updating the portfolio that some agencies had already placed. That is, although the area and the clients where the product has been placed are both clearly rural, the loans have been granted using an urban loan methodology as a way to replace the lack of a product specifically designed for this purpose. Replacing a rural methodology with urban has caused some inconveniences. For example, the loan officer feels that agricultural guarantees is very risky, or that making repayments on a more frequent basis (in urban repayment is typically made on a monthly basis) makes recovery management more complex, or that economic assessment – although simpler – requires information which is not necessary in urban methodology. In general, resistance is highly related to the natural reaction of loan officers who have gone from being single-product to multi-product, mainly in those rural areas of loan officers who serve the commerce and service sectors.

✓*Portfolio of products*

The rural products portfolio considers four lending modes: Multipliers, Solidary Nuclei, Solidary Groups and Individual. These products differ from one another in regards to their requirements, the type of collateral, amounts and terms, among other things. Additionally, they are defined to a great extent by the client's profile (See Annex C).

Since products form part of an integrated portfolio, clients can move from one product to another very easily. This allows to not only accompany the clients in their growth, but to also help them meet their needs and growth expectations, in light of their capacity and willingness to repay. However, this does not mean that the products must be sequential. Any client – depending on his/her profile – can use any of these lending products.

Having a comprehensive portfolio has the advantage that on one hand, loan officers assume the total of the portfolio and market it in a comprehensive manner. This prevents the loan officer from having to force a client to use one product simply because there is no other

product to offer. This, in turn, minimizes the resistance of loan officers that normally occurs when an organization has managed a single product for a long period of time and an additional product is incorporated. Or, even worse, when a specialist loan officer is added to market a new product in the same market of the original product (this strategy is sometimes adopted because the loan officer's profile does not adapt to the new product, as is the case of multiplier loan officers vs. individual lending loan officers).

Below are some differences between urban product and rural products.

URBAN PRODUCT	RURAL PRODUCT
Door-to-door promotion	Promotion through contact with leaders
Publicity on traditional massive media	Publicity focused per areas, in local media, with specific and singled characteristics
Number and nature of more abundant and formalized documentation	Fewer documents and less formal documentation substitutes are accepted
Mortgage, personal, collateral guarantees, etc, generally legalized	Agricultural collateral accepted as guarantee, non-legalized ownership titles, solidarity, etc.
Economic analysis of dominant business to be financed	Analysis of the entire family economic unit and its multiple activities and business.
Static analysis	Credit analysis that includes forecasted flows; seasonal and historical approach used in urban microcredit is eliminated.
Depth and scope of a similar analysis for different products	Depth and scope of the analysis depending on the product, designed to be gradually more complex.
Formalized disbursement at bank's teller windows	Disbursement in the field.
Less flexible terms and repayment mode, without grace periods or repayment upon maturity.	Terms and repayment schedule dependent upon the economic flows of the family unit involving the possibility of granting loans with capital or total grace periods, special schedules (deferential dates and quotas), interest-only payments, capital-only, or a combination of both, always as a function of activity flow and payments upon maturity.
More limited possibility to access parallel loans.	Possibility to access parallel loans (two loans for the same activity or two outstanding loans for the same client for different activities).
Collection in the field neither allowed nor necessary.	Carrying out collection in the field necessary due to geographical dispersion of rural areas.
No training provided as part of the lending process.	Training on basic human or economic development topics is a common aspect in

	group products.
Repayment capacity determination and guarantees are key issues in risk management.	Consolidation and reconciliation processes are key issues in risk management.

URBAN PRODUCT	RURAL PRODUCT
More regulated, controlled and less flexible loan restructuring.	Flexibility with structured processes to accept debt restructuring due to acts of God such as: plague, weather factors, price drops and others situations to which rural area inhabitants are more vulnerable.
Savings not linked to lending operations.	Savings as an integral part of lending operations
Software with traditional and single payment mode, fixed quota, growing capital amortization.	Specialized software includes repayment modes and dates according to agricultural cycles and activities.

A key element for rural economy viability is linked to production capacity (regarding quality, standardization and volume), and commercialization. Support required by rural area managers is considerable, and in general, they are not being served. While the bank's policy – as a regulated entity – is not to handle non-financial products because of its connection and alliance with Fundación Alternativa (and the support of the Belgian Technical Cooperation), it has carried forward – through the latter – training activities oriented to production improvement in quality and variety) as well as productive chains structuring and improvement.

✓*The cost*

The experience in Banco Solidario re-confirms the experience of other operators: rural lending – particularly agricultural lending – is more expensive on average than urban lending. However, it has also been proven that in spite of the burden of complying with regulations – especially those from external regulating entities – it is possible to integrate into the portfolio agricultural rural products that are financially viable within the context of a private regulated entity.

Some of the variables that enable cost reduction in rural loans are: the savings generated through group loans, portfolio distribution according to sectors and/or economic activities as a risk management mechanism, the automation of operational tasks (such as typing the information), the use of selection, segmentation and collection scores. All of these variables make the process more efficient.

✓*Challenges / learned lessons*

Human resources

With a lack of experience in agricultural loan management and considering that not all the loan officers and agency heads have an educational background in agriculture, and/or to the management of a rural portfolio, a strategic alliance was carried out with the University of Ibarra to incorporate fellow students to provide support as agricultural technicians. The technicians validate field information and develop support instruments (technical data sheets with production standards, cost and profitability of the products of the area and evaluation tables to evaluate agricultural guarantees.)

It was also necessary to restructure the incentives program – especially that of loan officers – incorporating considerations such as market dispersion, the number of hours demanded by group methodology, the support that the client requires in the process itself due to his or her profile, etc.

Another element in which the bank had to restructure was in the supply of uniforms, equipment and work material. In the case of rural loan officers, this meant the design of a uniform similar to that of urban loan officers, especially in those aspects in keeping with the corporate image, as well as providing motorbikes for daily transportation to the work areas.

In general, the coexistence of an urban profile and a rural profile sales force is a challenge that has required special attention. The purpose is mainly to maintain different guidelines (responding to the needs and profiles of human resources) while equally important, maintaining a unified sales force.

Operations

From the operational point of view the implications are very important. The agencies experienced an increase in client traffic, especially at the beginning, when the clients still preferred to accompany their group representative to perform the transactions at the bank, as well as interacting with the loan officer and/or requesting information.

It is important to consider the increase in data processing times, especially in the operations area. This includes tasks such as entering loan applications data and disbursement documents, especially in group lending (considering the requirements that need to be fulfilled for a regulated entity). These considerations and the impact on the organization's efficiency moved the institution toward the introduction of a mobile system that allows a significantly reduces the amount of time spent on operational tasks.

A challenge that has significantly affected the products – mainly regarding transaction cost for the client and for the bank – is the imprudence of disbursing loans in cash in the field because of safety concerns for the loan officers. This forces the clients to go to the branch which in most the cases is a considerable distance for the clients. To date, the bank is exploring alliances with several financial institutions located in the rural areas (such as cooperatives, mutual entities etc.) that will allow the bank to use the tellers' windows to make and to receive payments. This is necessary because infrastructure installation in

remote areas would represent an additional cost that would divert resources from loan placement, which is unjustified because the portfolio has not yet achieved volume.

Marketing

Product advertising required important modifications both in service platform (provided with a sales speech) and disbursement adjusted to the segment, as well as in promotion and publicity. This required important efforts in its design and development stage since the bank had not targeted this market with a promotional campaign and therefore lacked experience in the appropriate type of message and means to be used.

Culture

When the project started, Banco Solidario only served the urban area. Although the project included a strong training component – in a classroom and in the field – this was not enough given the differences and behaviors of by rural clients. Rural clients, especially those of the group modalities, require service from the bank's staff that is more focused on their particular needs and characteristics.

In this sense, pilot agencies experienced challenges that could have been better faced if a sensitivity training had been added, allowing staff to better understand and be better prepared for interacting with this segment of the market.

Regulations/Government Policy

In the products marketed through the bank (and contrary to the product marketed by Fundación Alternativa), it was necessary to incorporate requirements that responded to the regulating entity demands of the Banking Superintendency. This, in large part, became an obstacle in granting the loan because clients, although they could demonstrate repayment capacity and willingness, did not have certain documents like the voting ticket. Or, illiterate clients were asked to notarize their signature before witnesses which caused an additional cost (both in time and money), or the legal ownership of a client's property could not be proven.

On the other hand, at the beginning of the rural loan pilot, the government decided to grant a Poverty Voucher (around \$12) to those who fulfilled certain conditions proving a certain level of poverty. Potential and effective clients of group products reported that they would lose the voucher if they accessed the loan, as a consequence thereof some effective clients deserted immediately, and others – even potential clients – canceled their applications. This caused a negative impact on group loans placement in populations with greater needs. Facing this challenge, the bank started negotiations with the Ministry of Social Well-being who at the beginning asked for a comprehensive presentation of what Microfinance means, who and how are these loans negotiated, and the impact expected in the clients that use these products in terms of their own development and well-being. After several weeks of meetings, the Ministry issued a communication on April 25 2002, whereby making an exception assures that those clients having access to those loans may also access the Poverty Bonus. This shows the type of negotiation and cooperation that can be achieved

with government entities to start eliminating the numerous obstacles to implementing rural lending.

An interesting aspect to be considered is that a client who could not receive the voucher if he/she received a bank loan could receive the same loan through a non-regulated entity without losing the voucher. In this case, the Foundation that marketed the product Expanded Solidary Loan was not affected by this government policy.

✓The impact

To date, assessing the impact of this project would be premature. Only by anecdotal information and by sampling it is possible to observe an increase in the family unit income, in education improvement and nutrition, in creating/maintaining employment due to a significant increase in the participation of revenue generating secondary activities. For example, a flower grower wage-earning worker with a constant income has an arts and crafts activity that was less economically important. However, the arts and crafts activity becomes important when capital is injected, turning into a source of income and in many cases, into a main source of income. This income, in turn, facilitates greater income stability and keeping the job – that the entrepreneur requires in his business – which indirectly leads to better life conditions of his family unit.

Similar to client service, another aspect that the bank has been monitoring through qualitative studies is how quick access to financial services impacts the business. (Loan disbursement averages between 4 to 15 days depending on the product and the type of guarantee.) This enables the client to perform timely investments in his or her business.

Annex A

BANCO SOLIDARIO'S MISSION

We are an Ecuadorian organization focused on reducing poverty, by satisfying the needs of the market segments that face barriers to access the traditional financial system, with innovative and good quality products and financial services that generate our clients' loyalty.

We reward, with financial and social profitability, the trust of our depositors, investors, shareholders and collaborators, through the competitive management of a qualified and cheerful human team that makes of this mission a part of their life mission.

DEPTH OF THE SCOPE AND CLIENTS IN SIERRA NORTE IN EQUATOR

COMPONENT	BANCO SOLIDARIO December/2002	FUNDACIÓN ALTERNATIVA December/2002	TOTAL FIGURES
RURAL PORTFOLIO			
1 Individual Rural Lending			
Individual rural lending portfolio Regional Sierra Norte	\$3,026,230	\$ 0	\$3,026,230
Individual rural lending portfolio Regional Sierra Centro. Estimate	\$1,986,142	\$0	\$1,986,142
Total Individual Rural portfolio	\$5,012,372	\$0	\$5,012,372
1.2 Rural Group Lending			
Group rural lending portfolio Regional Sierra Norte.	\$ 64,721.96	\$192,434.00	\$257,155.96
Total Rural Group portfolio	\$ 64,721.96	\$192,434.00	\$257,155.96
TOTAL RURAL PORTFOLIO (INDIVIDUAL & GROUP)	\$5,077,093.00	\$192,434.00	\$5,269,527.00
2. EFFECTIVE CLIENTS			
2.1 Individual Clients			
No. of effective clients individual rural methodology Regional Sierra Norte.	2304	0	2304
No. of effective clients individual rural methodology Regional Sierra Centro.	965	0	965
TOTAL INDIVIDUAL CLIENTS	3269	0	3269
2.2 Group Clients			
No. of effective clients rural Group methodology Regional Sierra Norte.	342	1,466	
TOTAL GROUP CLIENTS	342	1466	1808
TOTAL RURAL CLIENTS (INDIVIDUAL & GROUP)	3611	1466	5077
3.0 INDICATORS			
3.1 Delinquency			
Individual Portfolio Delinquency (1 day)	3,42%		
Rural group portfolio delinquency (1 day past due)	0 %	0,85%	
3.2 Savings			
Accumulated Savings	\$ 527,250.00	\$9,258.17	
3.3 Loans average amount			
Individual	\$1553	\$0	
Group	\$189	\$ 144 new \$ 348 re-loans	
Geographical coverage	CAYAMBE: 10 locations OTAVALO: 7 locations IBARRA: 8 locations CHIMBORAZO : 4 locations AMBATO: 7 locations	IBARRA Office: 9 locations	

ANNEX C PORTFOLIO



ANNEX D

BREAK EVEN POINT OF A TRANSACTION WITH FINANCIAL COST

	<i>RURAL LOANS</i>	<i>URBAN LOANS</i>
LOAN AMOUNT	850,00	540,00
RATE	19,00%	19,00%
TERM MONTHS	7,00	7,00
COMMISSION	1,80%	1,80%
FINANCIAL COST	8,00%	8,00%
INTEREST	51,46	39,56
COMMISSION	107,10	68,04
TOTAL REVENUES	158,56	107,60
FINANCIAL COST	39,67	25,20
TRANSACTION COST	119,06	81,82
TOTAL COSTS	158,73	107,02

**URBAN LENDING WITHOUT FINANCIAL
COST NOR PROVISIONS**

Activities	Cost	Unit Cost	% Share.
Promotion	36.900,86	11,33	13,84%
Evaluation	73.372,60	22,52	27,53%
Approval	25.676,71	7,88	9,63%
Disbursement	23.143,97	7,10	8,68%
Recovery	35.832,56	11,00	13,44%
Re-lending	25.676,71	7,88	9,63%
Verification	9.814,36	3,01	3,68%
TOTAL COST DIRECT ACTIVITIES	230.417,77	70,73	86,45%
Administrative	3.554,38	1,09	1,33%
Operation entry control	15.763,70	4,84	5,92%
Becoming effective	3.535,00	1,08	1,32%
Accounting and portfolio balancing	5.857,41	1,80	2,20%
Custody	3.861,42	1,18	1,45%
Tells Control	3.556,80	1,09	1,33%
TOTAL COST OF SUPPORT ACTIVITIES	36.128,71	11,09	13,55%
TOTAL COST OF PRODUCT	266.546,48	81,82	100,00%

**RURAL LOANS WITHOUT FINANCIAL
COST OR PROVISIONS**

Activities	Cost	Unit Cost	% Share.
Promotion	30.803,53	16,68	14,01%
Evaluation	61.248,84	33,17	27,86%
Approval	21.434,00	11,61	9,75%
Disbursement	13.201,44	7,15	6,00%
Recovery	29.911,75	16,20	13,61%
Re-lending	21.434,00	11,61	9,75%
Verification	9.814,36	5,32	4,47%
TOTAL COST DIRECT ACTIVITIES	187.847,92	101,74	85,45%
Administrative	3.554,38	1,93	1,62%
Operation entry control	13.158,98	7,13	5,98%
Becoming effective	1.998,59	1,08	0,91%
Accounting and portfolio balancing	5.857,41	3,17	2,66%
Custody	3.861,42	2,09	1,76%
Tells Control	3.556,80	1,93	1,62%
TOTAL COST OF SUPPORT ACTIVITIES	31.987,58	17,32	14,55%
TOTAL COST OF PRODUCT	219.835,50	119,06	100,00%